American Stores Company

Annual Report 1978

Year ended April 1, 1978

AMERICAN STORES COMPANY . . . in the nearly 90 years since the founders of the Company started serving the public, dramatic changes have occurred in the variety and quality of merchandise offered for sale in retail food and drug stores A scene from one of the early American Stores Company units and some products which today are available throughout the year are pictured on the cover.

American Stores Company subsidiaries today operate modern food markets, drug stores, restaurants and general merchandise stores serving an area containing approximately one-fourth of the population of the United States with:

ACME MARKETS, INC.
. . . 455 food stores in Delaware, Maryland, New Jersey, New York, Pennsylvania, Virginia and West Virginia.

ALPHA BETA COMPANY
. . . 299 food stores in California and Arizona.
. . . 11 drug stores in California.
. . . 33 family restaurants in California.
. . . 3 general merchandise stores in California.

REA AND DERICK, INC.
. . . 123 drug stores in Pennsylvania and New York

HARDEE NORTHERN INC.
. . . 12 fast food restaurants in Pennsylvania, New Jersey and Delaware.

The annual meeting of shareholders will be held at the Hotel du Pont, 11th and Market Streets, Wilmington, Delaware on July 27, 1978 at 2 p m

FINANCIAL HIGHLIGHTS

Fiscal years ended April 1, 1978 and April 2, 1977

	1978	1977	Change
Sales	$3,737,634,000	$3,464,655,000	+7.9%
Net Earnings	$ 26,596,000	$ 25,819,000	+3.0%
Dividends Declared	$ 11,108,000	$ 9,989,000	+11 2%
Per Common Share Net Earnings	$5.03	$4.91	+$.12
Dividends	$2.10	$1.90	+$.20

REPORT TO SHAREHOLDERS:

Another record in sales volume was attained in the fiscal year ended April 1, 1978. Earnings also improved aided by a rising profit trend during the second half of the fiscal year Sales totaled $3,737,634,000, a 7.9% gain over the preceding year Earnings were $26,596,000 or $5.03 per share compared to $25,819,000 or $4 91 per share. This after tax increase resulted from a more favorable effective income tax rate of 44.1% for fiscal year 1978 compared to the rate for the year earlier of 47.2%. An important influence on the tax rate was the increase in the investment tax credit from $2,382,000 to $3,823,000 due to a higher level of capital expenditures.

Although the rate of inflation for food generally escalated as the year progressed, the rate assumed earlier for the portion of our grocery inventories valued by the LIFO method remained relatively level. Even though prices of meats and produce were increasing, grocery prices overall were more stable because some of the items, like coffee, which were extremely high-priced last year, had peaked earlier in this past year and then declined somewhat

All of the operating companies participated in this improved performance, which was enhanced at year end by strong Easter holiday business

At the May meeting of the Board of Directors, the quarterly dividend payable July 3, 1978 was raised to 56 cents from the 52½ cent rate in effect for the past year This is the seventh increase in the cash dividend rate since the end of calendar year 1973

All of our major operating companies have strong building programs scheduled. Net capital expenditures for the current year are targeted at $80,000,000. We have identified a number of promising areas which we feel can be developed currently, and we have included as many of these in our retail store program as can be accomplished in the near future It is our intention to expand as rapidly as sound judgment and our financial resources permit. In addition, we will be making some improvements in the non-retail facilities needed to support our retail store operations. Although the planned expenditures for fiscal 1979 represent the highest level of capital expenditures in the Company's history, our present financial resources are strong, and we do not anticipate the need for any additional major financing in the current fiscal year.

Two factors tended to make last year a difficult one. Adverse weather conditions handicapped our operations on both Coasts during parts of the year. Also, severe competitive activity added to promotional costs and put pressure on margins. Despite these factors, our operating companies demonstrated their ability to make sound progress.

The forces of inflation may well push food prices up at a faster rate during this current year, as both merchandise costs and expenses reflect these conditions. It is encouraging that the Administration in Washington appears to be recognizing the seriousness of the problem of inflation to the Nation's well-being, and it is our hope that they will attack the root cause of unbridled deficit spending, painful as such restraint may be to some sectors of society

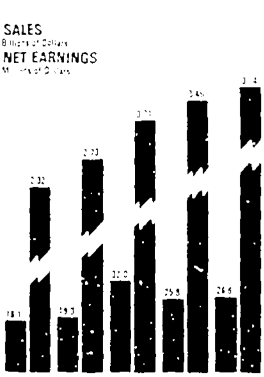
We see opportunities for our Company in both the densely populated corridor areas of the Middle Atlantic States and the expanding markets of California and Arizona. With the organizational strength and support of the more than 42,000 men and women who comprise the American Stores Company family, we look to the future confidently

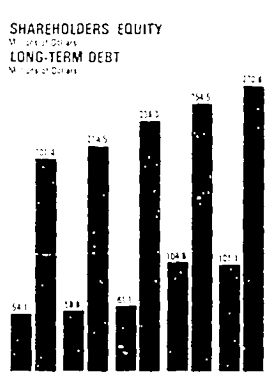
Respectfully submitted,

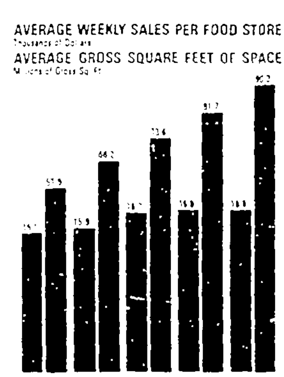
Chairman of the Board

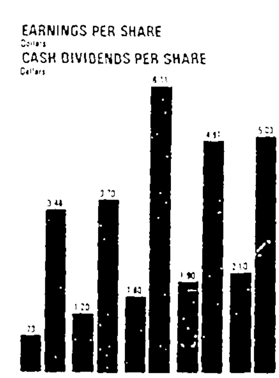
President and
Chief Executive Officer

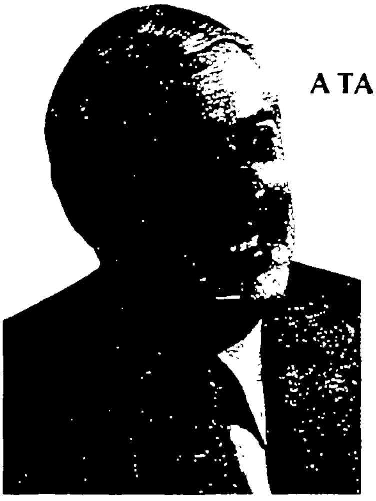
Wilmington, Delaware
June 7, 1978











William R. Deeley

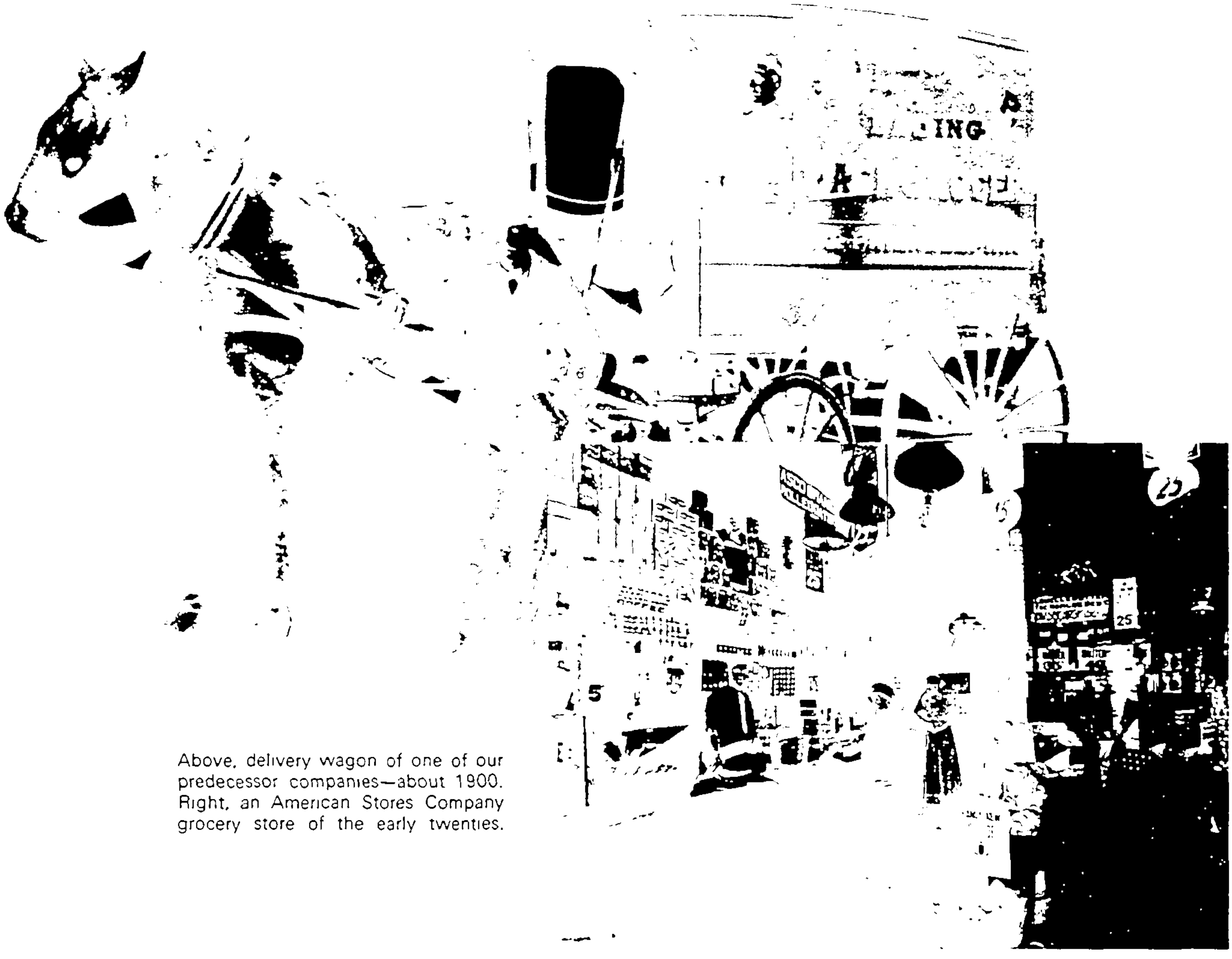
A TALK WITH THE CHIEF EXECUTIVE OFFICER

During fiscal year 1978, William R. Deeley, President of American Stores Company, was elected to the additional post of Chief Executive Officer His assumption of these new responsibilities provides him with a unique opportunity to reminisce about our Company's history (in which he has participated for the past 21 years) as well as to assess the current situation and our future In doing so, he answers a number of questions asked over the past year by stockholders, employees, financial analysts and others interested in the Company.

What is the background of American Stores Company?

Our Company had three beginnings

Acme Markets began in Philadelphia with the first grocery store of one of the predecessor companies



Above, delivery wagon of one of our predecessor companies—about 1900. Right, an American Stores Company grocery store of the early twenties.

opening in 1891. Alpha Beta stems from a single meat market started in Pomona, California in 1900. Rea and Derick commenced business in 1920 with its first drug store in Sunbury, Pennsylvania.

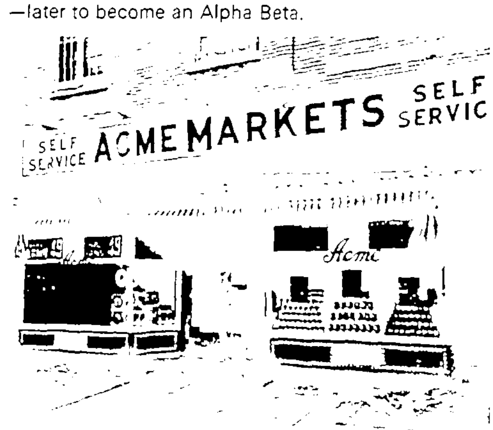
In 1917 the Acme Tea Company, the Bell, Childs and Dunlap companies, and Robinson & Crawford pooled their 1,223 stores, their bakeries and warehouses in one corporation. Through expansion and acquisition, Acme Markets now has operations in seven eastern states: Pennsylvania, New Jersey, Maryland, Delaware, New York, Virginia and West Virginia, making Acme the largest food retailer in the Middle Atlantic states. Our growth generally followed that of our great country and, in terms of number of stores, hit a peak in 1932 of almost 3,000 units. These stores had total sales of a little over $100 million and by that time the development of the supermarket was making the small service stores obsolete. Our Company faced the task of adapting the entire retail system to the self-service revolution during the depression years of the thirties and early forties.

Southern California was the location for the innovation called Alpha Beta. In 1914, at an early store in Pomona, one of the founders introduced self-service to his shoppers, encouraging his customers to "Serve themselves and save the difference." For the ease and convenience of shoppers, it was decided that items should be advertised and arranged alphabetically.

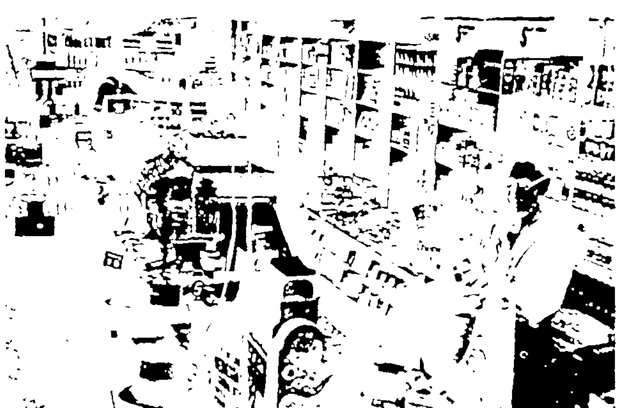
By 1955, Alpha Beta was operating 28 stores, mostly in Los Angeles and Orange Counties. In 1961 Alpha Beta joined forces with Acme Markets by way of a merger agreement. At that time, Alpha Beta's markets numbered 57 and had moved into the San Diego area. In the next 10 years, the number of Alpha Beta food stores almost tripled, and in 1970, 158 supermarkets were in operation, and the first units were opened in the San Francisco Bay area. In the

Robinson & Crawford store at the turn of the century.

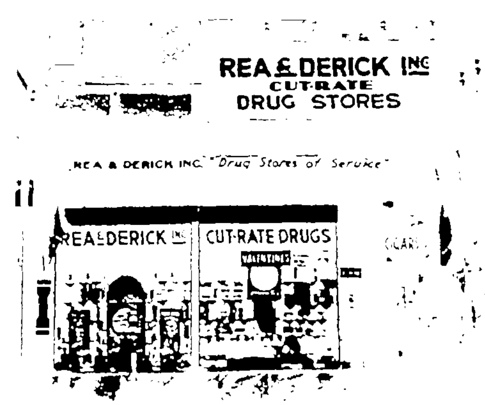
Gerrard Bros store—1923
—later to become an Alpha Beta.



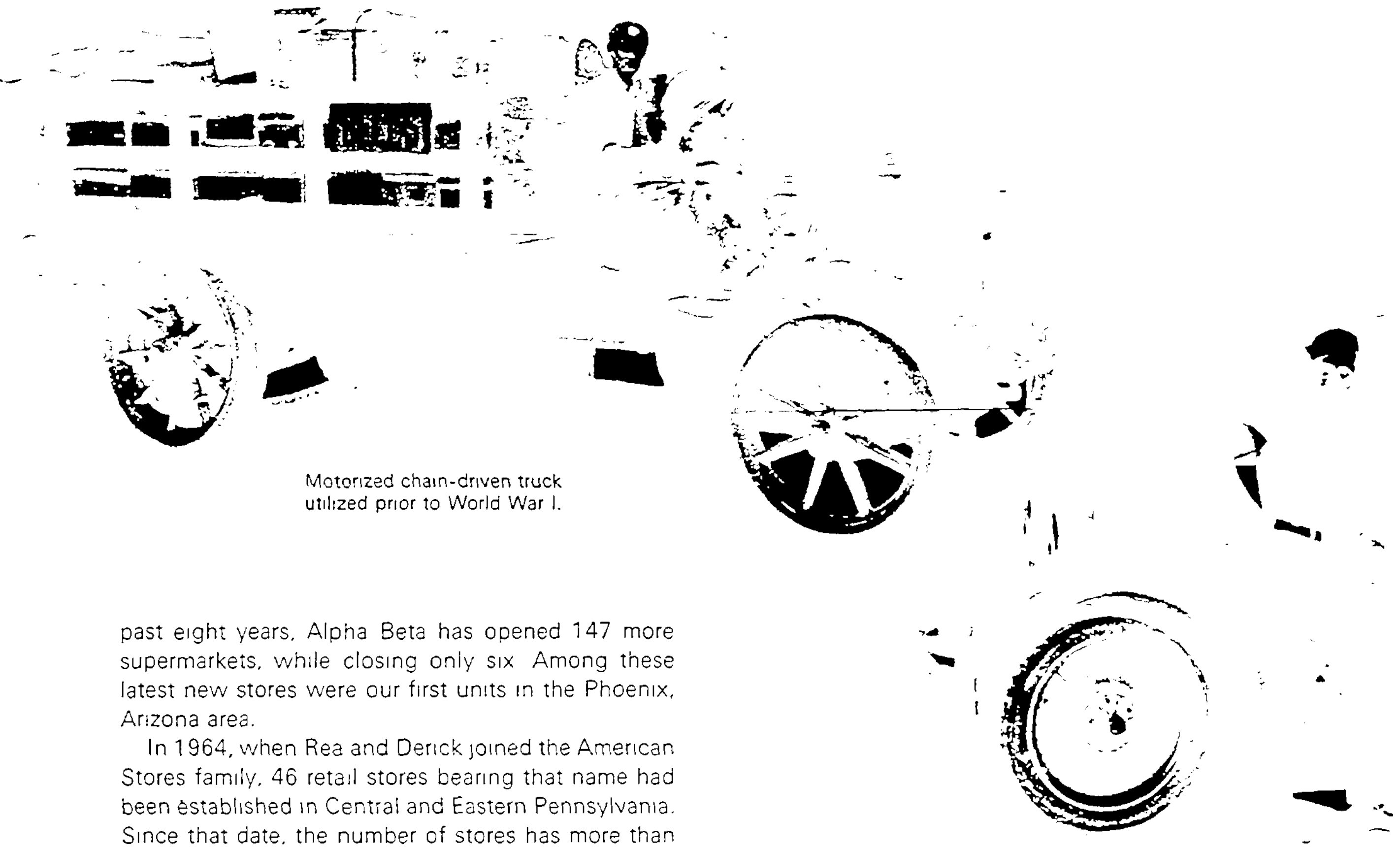
An Acme "self service" store of the 1930's.



Alpha Beta store interior of fifty years ago.



Rea and Derick drug store—1935.



Motorized chain-driven truck utilized prior to World War I.

past eight years, Alpha Beta has opened 147 more supermarkets, while closing only six Among these latest new stores were our first units in the Phoenix, Arizona area.

In 1964, when Rea and Derick joined the American Stores family, 46 retail stores bearing that name had been established in Central and Eastern Pennsylvania. Since that date, the number of stores has more than doubled.

Would you explain the corporate restructuring that took place several years ago?

Yes, on December 29, 1973 a new organizational structure was created which has enabled us to be even more effective in response to changing conditions in the business environment American Stores Company became a holding company, with Acme Markets, Inc., Alpha Beta Company, Rea and Derick, Inc. and Hardee Northern Inc. as operating subsidiaries

How do you define the role of American Stores Company in relation to your subsidiary companies?

The primary role of American Stores Company is to develop corporate policies and plans and to coordinate their implementation by the several operating companies As the focal point for the Company's various businesses, we are heavily involved in the financial planning of the Company's growth and the determination of the best mix of capital resource allocation among the operating companies and the several lines of business in which we are engaged The parent company is in an unusually good position to provide policies, guidance, and assistance to the subsidiaries in areas of common concern such as accounting, cash management, engineering services, financing, law, planning and real estate activity.

How many stores do your operating companies now have in operation?

In the Middle Atlantic states, Acme Markets, Inc. now operates 455 food stores, and Rea and Derick, Inc 123 drug stores In addition, Hardee Northern has 12 fast food restaurants Our eastern marketing area has a population of about 28 million people.

On the West Coast we consider California and Arizona our present market In this area, with a population of 23 million, Alpha Beta operates 299 food markets, 33 restaurants, 11 drug stores and 3 discount department stores

So, in total, we have the opportunity to serve over 50 million people While we're proud that our retail food stores hold the Number One position in our major market on each coast, Greater Philadelphia in the East and Southern California including San Diego in the West, we still have great potential to grow in our present areas

What are your store building and remodeling plans for the current fiscal year?

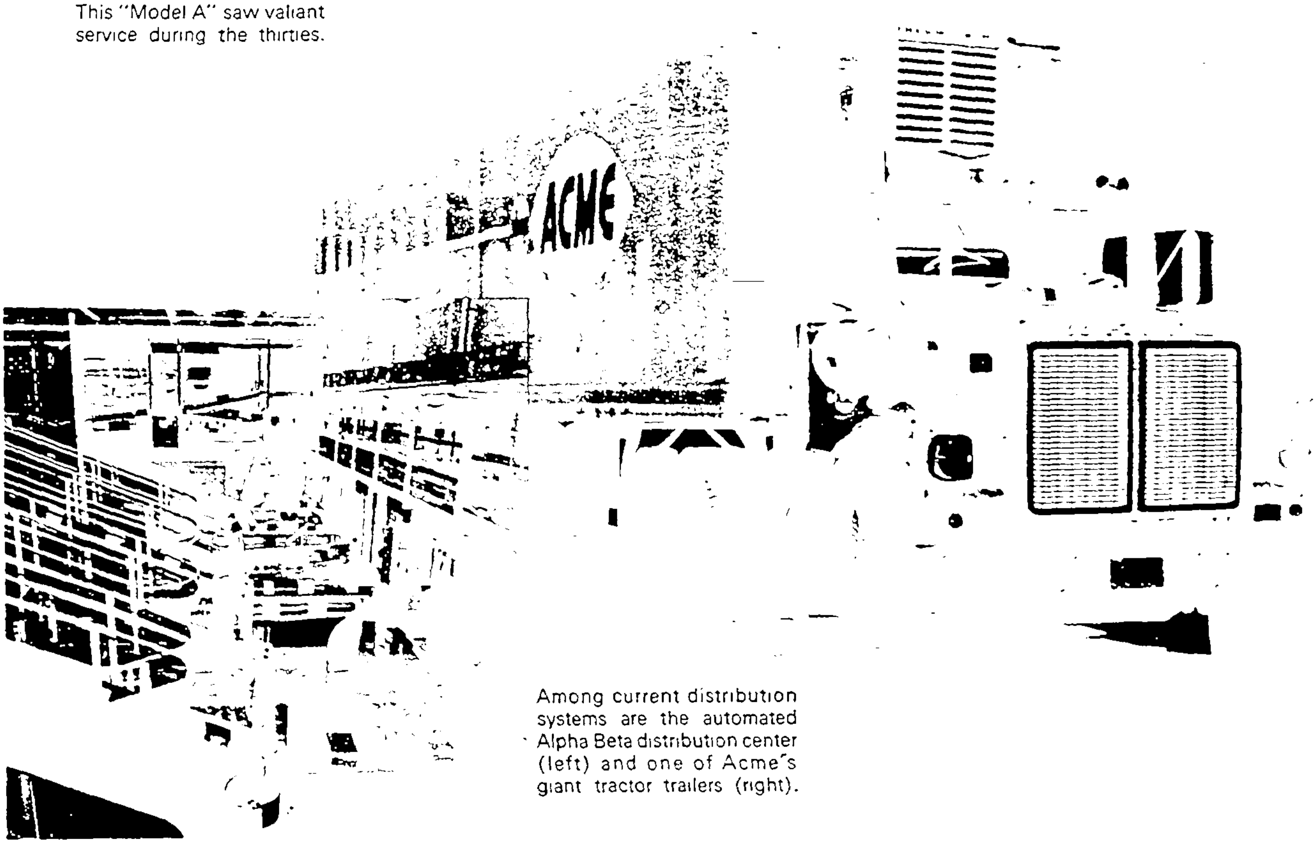
We plan to open 42 new food stores and complete 11 enlargements to existing food stores during this year. Also scheduled are 13 new drug stores and 10

restaurants. The activity for this fiscal year represents the first in a 3-year plan for accelerating our retail store program. We feel this program will contribute measurably to improved sales and earnings over the next several years. Our program of modernizing retail units will be continued by the remodeling and re-fixturing of 33 units and the refurbishing of a number of others.

This "Model A" saw valiant service during the thirties.

How do you plan to improve profit margins for the Company?

Our key objective is to attract as many customers to our stores as possible. We look on sales gains as the basic building block for improvement in earnings. One of the advantages of the larger supermarkets is that they afford the opportunity to display additional kinds of merchandise. We are constantly striving to offer a mix of merchandise that is not only attractively priced but which will also provide us with satisfactory profit margins. We are always looking for new items and new product families that will give us better margins. At the same time we are pressing to keep the costs of doing business from eroding our merchandising profits. Successful efforts to generate incremental sales coupled with vigilant expense controls are enabling



Among current distribution systems are the automated Alpha Beta distribution center (left) and one of Acme's giant tractor trailers (right).

us to make selective improvements in our profit structure. Our immediate goal is to reach a level of 1% net earnings to sales. Accomplishment of this goal will significantly increase the ability of our Company to attract the new capital necessary to sustain our profitable growth. We must provide a solid capital base for continued growth and also make the technological advances in our business that will offer us a better return in the future.

What do you believe are the paths of future growth for American Stores Company?

We are in a favorable position to move ahead in several areas of retailing besides food. We have a healthy and expanding participation in drug stores and restaurants. Our basic philosophy is to be responsive to consumer needs and to be ready to adapt to any changes in retailing in these three fields. With a strong geographical representation in both the densely populated eastern portion of the country and the more rapidly growing areas of the West, we are already in a position to move quickly to accommodate to new trends in retailing and to take advantage of new opportunities that present themselves.

What do you consider to be some of your strengths as you face the future?

Our retail store network has become much more productive and efficient in the last few years. New stores have averaged in excess of 30,000 square feet. A large number of smaller, older stores have been closed and many existing stores have been enlarged or modernized. From this point forward we can "fill in the network" with new, larger, trend-responsive stores in the faster growing areas of the markets we already serve. An advantage of growth in this manner is that customers know us, our people, our values and our type of merchandising.

Left, typical delicatessen in a 30,000 square-foot-plus supermarket. Below, an overall view of one of the latest Acme stores.

One of these values is our private label line of merchandise We are able to offer our customers a private brand line of merchandise which includes nearly 2,000 products These brands provide customers with quality that is equal to that of nationally advertised products, but at considerable savings Many of these items are made in our subsidiaries' own processing plants, enabling the Company to carefully control their quality and taste characteristics Some of our private label products are featured on the cover of this report

Moreover, dramatic advances have been made in the support facilities and distribution system providing services to our retail stores These improvements in productivity and efficiency are necessary if we are to continue to offer our customers merchandise at the lowest possible cost

An example of the improvement that has been made in the efficiency of the distribution system is at Alpha Beta's La Habra, California distribution center, where the output of pieces per hour was doubled by adding a third conveyor loop and initiating a batch-pick system Further fine tuning of that mechanized system has raised output an additional 14%, a performance gain that translates to lower delivered cost to Alpha Beta's stores A picture of a part of that facility is included in this report

Our program of modernization of support facilities is a continuing one The re-equipping of the recently leased large bakery building in the Philadelphia area is proceeding on schedule It will begin supplying the Acme stores in the Delaware Valley by January, 1979 and be in full production by early 1980 A lease has been executed for a new general merchandise distribution center in the Lancaster, Pennsylvania area. The new facility will replace a leased structure in that vicinity and will provide an even more efficient means of acquiring and distributing a broad line of

At new store open house, produce merchandisers and managers meet and exchange ideas and experiences.

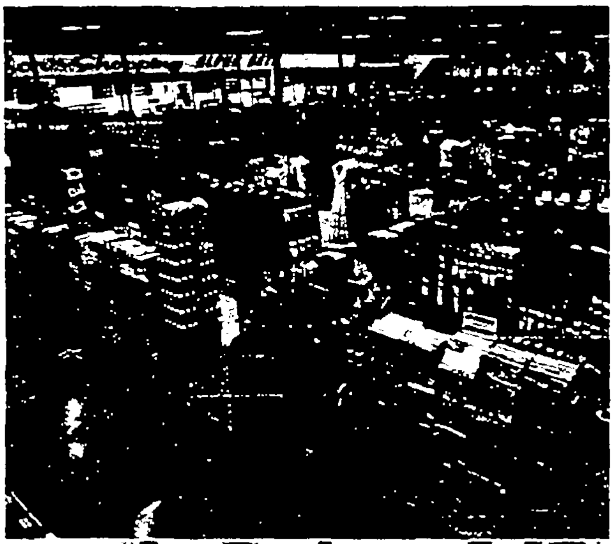
Interior of recently opened Rea and Derick drug store.

general merchandise products to all Acme stores. The latest material handling equipment planned for the facility will aid in the efficient distribution of this increasingly important line of merchandise. Initial shipments are scheduled for January, 1981

The recent addition to the Rea and Derick distribution center is in full operation and should meet the demands of their growth program for the next several years

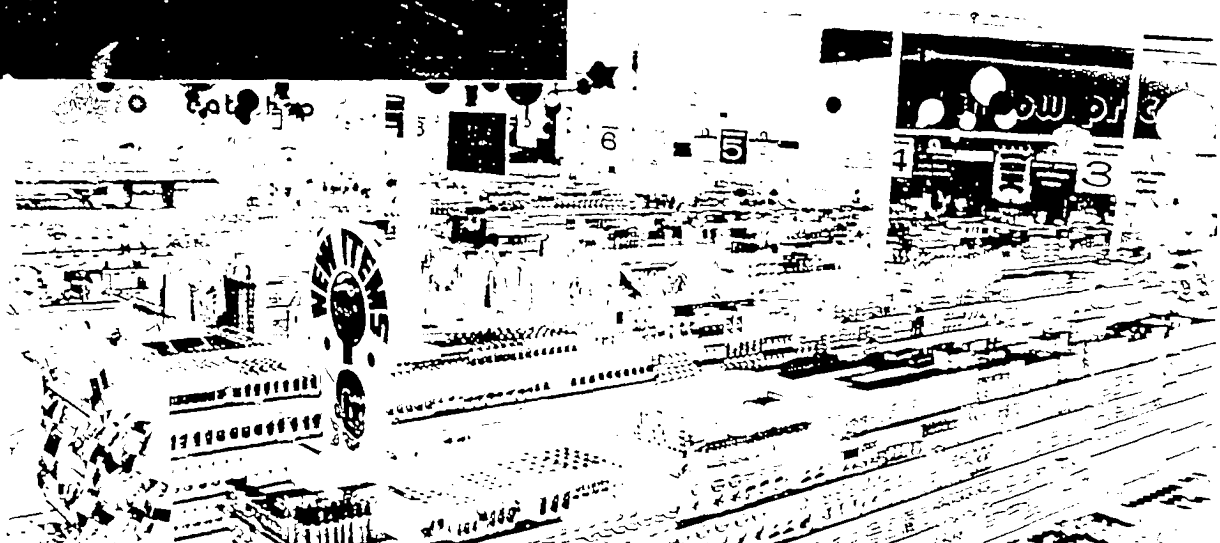
What is the Company's dividend policy?

We recognize that we have two financial obligations to our shareholders. to provide them with a reasonable return on their investment in the form of cash dividends and to retain a prudent amount of earnings to invest in new or modernized facilities to increase the underlying value of their stock ownership The Board of Directors is always conscious of these objectives



What are you doing to conserve energy?

We are doing a number of things to conserve energy. Naturally we want to do all we can as a good corporate citizen to meet this important national goal. Also, we have another interest—that of controlling costs Utility rates are increasing faster than most of our other expense items A cornerstone to our conservation program is the power management program, a computerized system that not only controls energy use but also monitors in-store maintenance service Experience to date indicates that the maintenance benefits derived from the system may equal, or even exceed, the energy cost savings obtained



Above, general merchandise department of type being installed in our new supermarkets. Below, one of the recently opened Alpha Beta markets

Are you planning to install scanners in your stores?

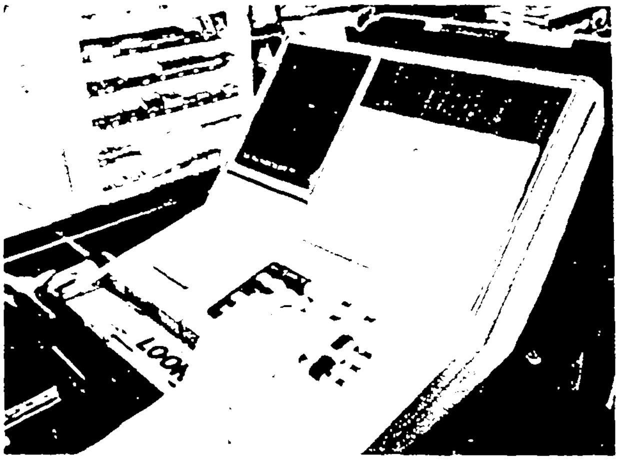
At the present time, we are continuing to install electronic cash registers in our stores. Approximately 50% of our supermarkets are now using these electronic devices, which add speed and accuracy to the checkout operation During the past fiscal year, 93 supermarkets were equipped with electronic registers and the forecast for this year is for installations in 100 more stores. Electronic registers are also being used in approximately 50 of our other retail units. In addition, customer service has been improved by a Checker Touch Certification Program initiated by Alpha Beta in early 1978 The emphasis in this training program is on accuracy using the keyboard "touch system," but speed and efficiency have also improved.

Scanners can be added to these electronic cash registers Currently, we have scan systems in three stores and will install at least one additional unit this year so that we can continue to monitor the advantages to be obtained by using this equipment in high volume markets

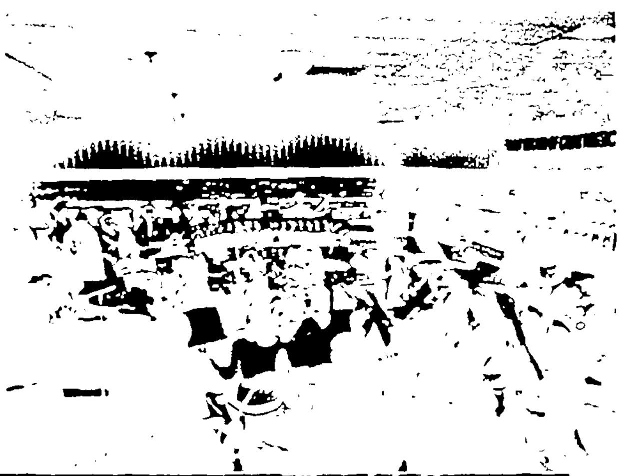
What is your philosophy as to your companies' participation in civic and community affairs?

As a responsible corporate citizen, we believe that both the Company and our employees should play an active role in the affairs of the communities where we operate

We believe that it is in the enlightened self-interest of the Company to give financial support to selected civic and community activities and to encourage our people to share in this commitment



Electronic cash registers are keyed to help provide more efficient customer service.



Above, the Philadelphia Philharmonic Orchestra plays at a recently opened Acme store as part of a classical record promotion. Below, one of the many banners presented to outstanding school and youth groups in the Acme operating area.

MANAGEMENT'S ANALYSIS OF EARNINGS

The following discussion of material changes in the Company's operations compares fiscal year 1978 with fiscal year 1977 and fiscal year 1977 with fiscal year 1976. The five year summary of earnings appears on page 11.

The Company's sales increased by 7 9% in fiscal year 1978 compared with 1977 and by 8% in fiscal year 1977 as compared with 1976. Fiscal years 1978 and 1977 included 52 weeks while fiscal year 1976 was a 53-week year. After adjustment of fiscal year 1976 sales to a comparable 52-week basis, the sales increase in fiscal year 1977 was 10.1% In both fiscal years 1978 and 1977, increased sales resulted from a combination of greater sales volume in existing units and the effect of new, remodeled and enlarged retail facilities placed in service during those years. During fiscal year 1978, gross square feet of food store space increased to 16.941 million square feet at year end from 16.699 million square feet at the beginning of the fiscal year as 18 food stores were opened and 24 older, smaller stores were closed. During fiscal year 1977, 16 new stores were opened and 43 older, smaller stores were closed. The 1977 sales increase was moderated somewhat by a meat cutters' strike during the fourth fiscal quarter which closed the food stores in the Delaware Valley for 10 days and caused the same stores to operate without a meat department for 9 additional days

The cost of merchandise sold increased by 6 7% when comparing fiscal year 1978 with 1977 and by 8.1% when comparing fiscal year 1977 with 1976. In fiscal year 1978, the cost of merchandise sold increased at a lesser rate than the sales of the Company. This was due, in part, to an amelioration of the effects of a period of unusually intense price competition in the Company's major supermarket operating areas in the previous year. However, during fiscal year 1977, merchandise costs rose at a slightly greater rate than sales as a result of continuing intense price competition in the Company's major supermarket operating areas in the early part of the year and an increase in the rate of inflation for those inventories costed using the LIFO method—particularly coffee—toward the end of the fiscal year. The Company uses the LIFO method of costing dry grocery inventories which has the effect of eliminating the impact of inflation from such inventory carrying values. The rate of inflation experienced in dry grocery inventories during the last year was somewhat higher than in the previous year. Inventories valued at LIFO cost would have been $38.2 million higher at the end of fiscal year 1978 and $28 7 million higher at the end of fiscal year 1977 if the FIFO and average cost methods of inventory valuation had been used.

Operating and administrative expenses increased during fiscal year 1978 by 14% and during fiscal 1977 by 10 7% (both increases exceeding the comparable increases in sales) reflecting the continuing upward pressure on many items of expense, particularly promotional expenses, energy and labor related items, throughout the periods. During fiscal year 1978, depreciation and amortization increased by 11.1% as a result of additions to plant and equipment relating to the store opening and renovation programs. In the previous year such increase was 7.8%.

Interest expense increased 12 1% during fiscal year 1978 as opposed to a much larger percentage increase in fiscal year 1977 when the Company issued $50,000,000 of 9⅝% sinking fund debentures for use in funding part of the capital expenditure programs for stores and support facilities during the next several years. Nonoperating income, principally interest income, rose substantially in both fiscal years 1978 and 1977, due primarily in the earlier period to the temporary investment of the proceeds of the debenture issue in interest-bearing securities pending the above-described use by the Company and, principally, during the most recent period, to continued improved management of working capital and higher interest rates.

Thus, during fiscal year 1978, net earnings increased 3% compared to a 19.2% decrease in the 1977 fiscal year An important contributing factor in this improvement in net earnings was the decline in the effective Federal and state income tax rate to 44.1% in 1978 compared to the rate for the year earlier of 47.2% The decline of 9 3% in those income taxes was due substantially to increased investment tax credit as a result of the facility and store building programs The investment credit earned amounted to $3,823,000 in 1978 and $2,382,000 in 1977.

WORKING CAPITAL

Capital expenditures in fiscal year 1978 increased to $52,453,000 compared to $37,689,000 in 1977. The higher level of expenditures largely reflects the acceleration of the Company's new store and existing store renovation programs. As a result of the stepped-up capital expenditures, working capital decreased by $1,749,000 to $170,036,000 at the end of fiscal year 1978 compared to 1977 year-end working capital of $171,785,000. The Company anticipated this change in working capital and expects this trend to continue as the planned capital expenditure program on which the Company has recently embarked continues as scheduled. However, the Company enjoys an extemely strong cash position and believes that its working capital is adequate to complete the planned capital expenditure program while at the same time operating at a higher level of sales volume without requiring major new financing this year.

CONSOLIDATED SUMMARY OF EARNINGS

	Fiscal Year Ended				
	April 1, 1978 52 weeks	April 2, 1977 52 weeks	April 3, 1976 53 weeks	March 29, 1975 52 weeks(a)	March 30, 1974 52 weeks
	(In thousands except shares and per share amounts)				
Sales	**$3,737,634**	3,464,655	3,207,248	2,734,710	2,320,322
Costs and expenses:					
Cost of merchandise sold, including warehousing and transportation expenses	**2,951,464**	2,765,131	2 557,185	2,197,610	1,866,172
Operating and administrative expenses	**701,746**	615,661	556,054	471,016	394,670
Depreciation and amortization	**33,828**	30,460	28,267	24,639	22,143
	3,687,038	3,411,252	3,141,506	2,693,265	2,282,985
Operating profit	**50,596**	53,403	65,742	41,445	37,337
Other deductions (income):					
Interest expense	**10,661**	9,509	6,504	6,167	5,699
Non operating items, net	**(7,631)**	(5,045)	(2,497)	(1,193)	(2,940)
Earnings before income taxes	**47,566**	48,939	61,735	36,471	34,578
Federal and state income taxes	**20,970**	23,120	29,770	17,150	16,515
Net earnings	**$ 26,596**	25,819	31,965	19,321	18,063
Average shares outstanding	**5,284,158**	5,255,000	5,230,407	3,480,273	3,479,858
Per share of common stock based on average number of shares outstanding during fiscal year (b):					
Net earnings	**$5.03**	4.91	6.11	3.70	3.46
Cash dividends	**$2.10**	1.90	1 60	1.20	.73

(a) Reflects adoption of LIFO method of valuation for certain inventories which reduced net earnings $8,521,000 or $1 63 per share
(b) Per share figures have been adjusted, where appropriate, for the three-for-two stock split effective July 1, 1975.

SEGMENT INFORMATION

Fiscal year ended April 1, 1978

	Supermarkets	Drug and general merchandise stores	Other	Adjustments and eliminations	Consolidated
	(In thousands of dollars)				
Sales to outside customers	$3,597,965	114,994	24,675		3,737,634
Intersegment sales	5,088			(5,088)	
Total sales	$3,603,053	114,994	24,675	(5,088)	3,737,634
Operating profit	$ 47,347	6,006	1,380		54,733
General corporate expenses					(4,137)
Interest expense					(10,661)
Nonoperating items, net					7,631
Earnings before income taxes					$ 47,566
Identifiable assets at April 1, 1978	$ 505,840	33,690	9,566		549,096
Corporate assets					98,377
Total assets at April 1, 1978					$ 647,473

Intersegment sales are priced on the basis of outside competitive market prices Depreciation and amortization for supermarkets and drug and general merchandise stores were $32,040,000 and $927,000, respectively Amounts expended for property, plant and equipment for supermarkets and drug and general merchandise stores were $48,634,000 and $1,591,000, respectively

AMERICAN STORES COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

Fiscal years ended April 1, 1978 and April 2, 1977

CURRENT EARNINGS	1978	1977
Sales	$3,737,634,000	3,464,655,000
Cost of sales and operating expenses:		
Cost of merchandise sold, including warehousing and transportation expenses	2,951,464,000	2,765,131,000
Wages, rents, advertising, administrative and other operating expenses	701,746,000	615,661,000
Depreciation and amortization	33,828,000	30,460,000
	3,687,038,000	3,411,252,000
Operating profit	50,596,000	53,403,000
Other deductions (income):		
Interest on long-term debt	10,045,000	8,806,000
Other interest expense	616,000	703,000
Nonoperating items, net (principally interest income)	(7,631,000)	(5,045,000)
	3,030,000	4,464,000
Earnings before income taxes	47,566,000	48,939,000
Federal and state income taxes (note 4)	20,970,000	23,120,000
Net earnings	$ 26,596,000	25,819,000
Net earnings per share of common stock	$ 5.03	4.91

EARNINGS RETAINED FOR USE IN THE BUSINESS		
Balance at beginning of year	$ 117,464,000	101,634,000
Net earnings for the year	26,596,000	25,819,000
	144,060,000	127,453,000
Deduct cash dividends—$2.10 a share in 1978 and $1.90 a share in 1977	11,108,000	9,989,000
Balance at end of year	$ 132,952,000	117,464,000

See accompanying notes to financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Fiscal years ended April 1, 1978 and April 2, 1977

SOURCE:	**1978**	1977
Net earnings	**$26,596,000**	25,819,000
Expenses charged against earnings not involving the current expenditure of funds:		
Depreciation and amortization	**33,828,000**	30,460,000
Deferred income taxes	**1,721,000**	4,916,000
Other	**211,000**	190,000
Total funds provided from operations	**62,356,000**	61,385,000
Long-term borrowing	**2,796,000**	53,614,000
Disposals of properties	**2,710,000**	3,031,000
Proceeds from sales of common stock pursuant to exercise of options	**599,000**	372,000
Miscellaneous, net	**1,198,000**	(38,000)
Total source of funds	**69,659,000**	118,364,000
DISPOSITION:		
Expended for property, plant and equipment	**52,453,000**	37,689,000
Reduction of long-term debt	**5,983,000**	10,389,000
Cash dividends	**11,108,000**	9,989,000
Investments and deferred charges	**1,864,000**	2,418,000
Total disposition of funds	**71,408,000**	60,485,000
Increase (decrease) in working capital	**$(1,749,000)**	57,879,000

CHANGES IN WORKING CAPITAL:		
Increase (decrease) in current assets:		
Cash and marketable securities	**$15,192,000**	45,292,000
Receivables	**1,978,000**	4,613,000
Inventories	**20,562,000**	19,124,000
Prepaid expenses	**3,048,000**	2,086,000
Properties to be developed and sold within one year	**(1,091,000)**	(1,030,000)
	39,689,000	70,085,000
Increase (decrease) in current liabilities:		
Current instalments of long-term debt	**483,000**	426,000
Accounts and dividend payable	**30,406,000**	28,807,000
Accrued expenses and taxes	**12,855,000**	(14,529,000)
Construction and other loans on properties to be sold	**(2,306,000)**	(2,498,000)
	41,438,000	12,206,000
Increase (decrease) in working capital	**$(1,749,000)**	57,879,000

See accompanying notes to financial statements.

AMERICAN STORES COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

April 1, 1978 and April 2, 1977

ASSETS	1978	1977
Current assets:		
Cash	$ 13,619,000	17,645,000
Short-term marketable securities, at approximate market	93,264,000	74,046,000
Receivables	17,472,000	15,494,000
Inventories, at lower of cost (last-in, first-out and other methods) or market (note 2)	272,463,000	251,901,000
Prepaid expenses	16,937,000	13,889,000
Properties to be developed and sold within one year	6,164,000	7,255,000
Total current assets	419,919,000	380,230,000
Investments, at cost or less	6,739,000	4,917,000
Property, plant and equipment, at cost (note 3):		
Land	16,736,000	17,482,000
Buildings	76,371,000	76,161,000
Machinery, equipment and fixtures	250,853,000	221,461,000
Leasehold costs and improvements	40,298,000	34,987,000
	384,258,000	350,091,000
Less accumulated depreciation and amortization	165,104,000	146,852,000
Net property, plant and equipment	219,154,000	203,239,000
Deferred charges, etc.	1,661,000	1,830,000
	$647,473,000	590,216,000

See accompanying notes to financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	1978	1977
Current liabilities:		
Current instalments of long-term debt (note 3)	$ 5,454,000	4,971,000
Accounts payable	164,141,000	136,517,000
Accrued expenses	68,987,000	62,449,000
Dividend payable	2,782,000	—
Federal and state income taxes (note 4)	6,653,000	336,000
Construction and other loans on properties to be sold	1,866,000	4,172,000
Total current liabilities	249,883,000	208,445,000
Long-term debt, excluding current instalments (note 3)	101,133,000	104,320,000
Deferred income taxes (note 4)	23,385,000	21,664,000
Other liabilities	2,443,000	1,245,000
Shareholders' equity:		
Preferred stock of $1 par value. Authorized 1,000,000 shares, issued none	—	—
Common stock of $1 par value Authorized 10,000,000 shares; issued 5,341,812 shares in 1978 and 5,305,004 shares in 1977 (note 5)	5,342,000	5,305,000
Capital in excess of par value of common stock (note 5)	133,354,000	132,792,000
Earnings retained for use in the business (note 3)	132,952,000	117,464,000
	271,648,000	255,561,000
Less 41,064 shares common treasury stock, at cost	1,019,000	1,019,000
Total shareholders' equity	270,629,000	254,542,000
Lease commitments and litigation (notes 6 and 8)		
	$647,473,000	590,216,000

NOTES TO FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Definition of Fiscal Year

The company's fiscal year ends on the Saturday nearest to March 31 Fiscal year 1978 ended April 1, 1978; fiscal year 1977 ended April 2, 1977 Both of these years comprised 52 weeks

Basis of Consolidation

The consolidated financial statements include the accounts of the company and all subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation

Inventories

Inventories are stated at the lower of cost or market The last-in, first-out (LIFO) method is used to determine the cost of certain categories of grocery inventories. Cost of the balance of grocery inventories and all other inventories is computed by either the first-in, first-out (FIFO) or average cost methods

Depreciation Policy

Depreciation and amortization charged to earnings for financial statement purposes are generally computed using the straight-line method applied to individual property items. For income tax purposes, depreciation is computed by accelerated methods applied to composite groupings of assets.

Maintenance, repairs, renewals and minor betterments are charged to earnings. Where betterments are significant in amount and tend to increase operating efficiency or capacity, they are capitalized and depreciated.

Plant and equipment which has become fully depreciated or fully amortized is charged off against the related accumulated depreciation or amortization

Costs of Opening and Closing Stores

The costs of opening new stores are charged against earnings in the year in which they are incurred When operations are discontinued and a store is closed, the remaining investment in fixtures and improvements, net of expected salvage, is charged against earnings and provision made for the remaining liability under the lease, net of expected sublease recovery.

Income Taxes

The company provides deferred income taxes or credits where there are timing differences in recording income and expenses for financial reporting and tax purposes. These timing differences relate primarily to accelerated depreciation and reserves not currently tax deductible

The company reduces its current income tax provision for investment tax credits in the year in which the credits arise.

Pension Costs

Pension costs are actuarially computed and include amortization of prior service cost over periods ranging to 30 years The company's policy is to fund pension costs accrued.

Net Earnings Per Share

Net earnings per share of common stock are based on the average number of common shares outstanding during the year. Common share equivalents in the form of stock options are excluded from the calculation since they have no material dilutive effect on per share figures.

(2) LIFO Inventories

Dry grocery inventories located in stores and warehouses of the company's food store subsidiaries are valued at last-in, first-out (LIFO) cost Such inventories amounted to $125,844,000 at April 1, 1978 and $121,166,000 at April 2, 1977 If the first-in, first-out (FIFO) and average cost methods had been used, inventories would have been $38,237,000 higher at April 1, 1978 and $28,737,000 higher at April 2, 1977.

(3) Indebtedness

A summary of long-term debt at April 1, 1978 and April 2, 1977 is shown below:

	1978	1977
9⅜% sinking fund debentures due July 1, 2001	$ 50,000,000	50,000,000
9⅞% sinking fund debentures due August 1, 1990	20,320,000	21,880,000
Notes payable due June 30, 1980	10,500,000	12,500,000
Mortgage loans payable	19,424,000	18,321,000
Industrial development revenue bonds due April 1, 1995	3,700,000	3,700,000
Purchase agreement	2,643,000	2,890,000
	106,587,000	109,291,000
Current instalments	5,454,000	4,971,000
Long-term	$101,133,000	104,320,000

Sinking fund payments, sufficient to retire $2,500,000 principal amount of the 9⅜% sinking fund debentures, are due annually beginning July 1, 1982. Annual payments of $1,560,000 are required to be made to the sinking fund for the 9⅞% debentures

The notes payable due June 30, 1980 bear interest at prime rate plus ½% (8½% at April 1, 1978), with a maximum average rate of 7½% to maturity. The notes are payable in quarterly instalments of $500,000 until March 31, 1980 with the remainder of

$6,500,000 payable at maturity

The various mortgage loans are payable in monthly instalments of approximately $282,000 through February 1, 1979 and lesser amounts thereafter through December 1, 2004 (applied first to interest and then to principal) and are secured by property, plant and equipment with a carrying value of $24,537,000. The loans bear interest at various rates, ranging from 6% to 10% (average 9⅔%).

Industrial development revenue bonds (average interest rate 7.4%) were issued to finance part of the cost of a food processing plant of a subsidiary leased from the municipality in which it is located. The annual payments made by the subsidiary are in amounts sufficient to pay principal and interest expense on the bonds Repayments of this debt are scheduled to commence on April 1, 1980 ($500,000) and range in amount from $200,000 in 1984 to $1,500,000 in 1995. The cost of the plant and related facilities have been included in property, plant and equipment as if they were owned by the company.

The purchase agreement relates to a distribution center property and requires equal semiannual payments through 1986 applied first to interest at 4¾% and the remainder to principal

The aggregate amounts of long-term debt maturing in each of the five fiscal years subsequent to April 1, 1978 are: 1979—$5,454,000; 1980—$5,533,000, 1981—$10,401,000; 1982—$3,191,000 and 1983—$5,140,000.

There were no short-term borrowings during fiscal years 1978 and 1977 except the construction and other loans on properties to be sold

The various loan agreements impose certain restrictions with respect to maintenance of working capital, amount of liabilities, payment of dividends and purchase of capital shares. Under the most restrictive covenant, earnings retained for use in the business in the approximate amount of $25,878,000 at April 1, 1978, were free of restriction.

(4) Income Taxes

Federal and state income taxes charged to earnings are summarized below.

	1978	1977
Current:		
Federal (before investment credits)	$19,670,000	17,683,000
Investment credits	(3,823,000)	(2,382,000)
State	3,402,000	2,903,000
Deferred:		
Federal	1,466,000	4,189,000
State	255,000	727,000
	$20,970,000	23,120,000

Deferred taxes for both 1978 and 1977 relate principally to the effects of accelerated depreciation.

The effective income tax rate differed from the statutory Federal income tax rate of 48% as shown below:

	1978	1977
Computed "expected" tax rate	48.0%	48 0%
State income taxes, net of Federal income tax benefit	4.0	3 9
Investment credits	(8.0)	(4 9)
Other, net	0.1	0 2
	44.1%	47 2%

The Federal income tax returns of the company for fiscal years 1969 and 1970 have been examined by the Internal Revenue Service, and all issues have been settled except one relating to imposition of a minor deficiency which the company is contesting The examination of returns for fiscal years 1971 and 1972 has been completed and certain disallowances by the Service are being protested. Returns for fiscal years 1973 through 1975 are currently under examination. Management believes that any adjustments arising from the final tax settlements will not have a material effect on the consolidated earnings or consolidated financial position of the company

(5) Common Stock and Capital in Excess of Par Value of Common Stock

Changes in common stock and capital in excess of par value of common stock are as follows:

	Common stock Shares	Common stock Amount	Capital in excess of par value of common stock
Balance at April 3, 1976	5,282,154	$5,282,000	$132,443,000
Sale of stock under stock option plans	22,850	23,000	349,000
Balance at April 2, 1977	5,305,004	5,305,000	132,792,000
Sale of stock under stock option plans	36,808	37,000	562,000
Balance at April 1, 1978	5,341,812	$5,342,000	$133,354,000

Under the company's stock option plans approved by the shareholders in 1964 and 1974, there were outstanding at April 1, 1978 options granted to officers and key management employees to purchase 185,678 shares of common stock at prices ranging from $14 92 to $30.13, such prices being equal to market value on the respective dates of granting The 1974 option plan provides for grant of either qualified or nonqualified options. Qualified options are exercisable on a cumulative basis over periods of five years or less and expire on or before April 27, 1981. Nonqualified options are exercisable on a cumulative basis over periods of 10 years or less and expire on or before January 25, 1988. The

NOTES TO FINANCIAL STATEMENTS (continued)

changes in options outstanding during the two years are summarized as follows:

	1978	1977
Shares under option at beginning of year	187,736	212,460
Additions (deductions).		
Options granted	35,400	—
Options exercised	(36,808)	(22,650)
Options expired or canceled	(650)	(1,874)
Shares under option at end of year	185,678	187,736
Average option price per share	$23.39	$20 76

No further options may be granted under the 1964 option plan

Under the 1974 plan, at April 1, 1978 an additional 77,500 shares of common stock were reserved for future option grants, and nonqualified options for 23,000 shares were outstanding. In 1978 compensation expense of $49,000 has been accrued in anticipation of exercise of nonqualified options.

(6) Lease Commitments

At April 1, 1978, the company and subsidiaries were lessees under leases covering retail locations and certain distribution center properties. The company conducts the major part of its operations from leased premises and the initial lease terms generally range from 15 to 20 years. Most of the leases contain renewal options which give the company the right to extend the lease for varying additional periods, often at reduced rentals

Over the years the company has accounted for its leases by the operating method pursuant to accounting principles then in effect. The provisions of Statement of Financial Accounting Standards No. 13 published in November 1976 and made effective for leasing transactions entered into on or after January 1, 1977, established new accounting rules for "capital leases" In fiscal year 1979 the provisions of Statement No. 13 will be applied by the company to all current leasing transactions and retroactively by restating its financial statements for previous years There have been no significant capital lease transactions subject to the accounting specified by Statement No.13 since January 1, 1977

Rental expense for fiscal years 1978 and 1977 was as follows.

	1978	1977
Minimum rentals, net of minor sublease rentals	$39,092,000	37,044,000
Rentals based on sales	5,016,000	4,308,000
	$44,108,000	41,352,000

Aggregate future minimum rentals, net of sublease rentals which are minor in amount, are approximately as follows for the fiscal years indicated:

1979	$ 38,677,000
1980	36,630,000
1981	34,876,000
1982	32,718,000
1983	30,159,000
Thereafter	266,379,000
	$439,439,000

Certain leases in effect at December 31, 1976 which are now being accounted for by the operating method will be classified and accounted for as capital leases under Statement No. 13. If the company had accounted for those leases as capital leases, assets would have increased by $154,340,000 and $155,111,000, and liabilities would have increased by $180,748,000 and $178,376,000 at April 1, 1978 and April 2, 1977, respectively. Net earnings would have been reduced by an estimated $1,570,000 for fiscal year 1978 and by an estimated $1,552,000 for fiscal year 1977

(7) Pension Plans

Substantially all employees of the company and its subsidiaries are covered by pension plans funded currently by payments to plan trustees or insurers. Employees who are members of bargaining units are covered by union-negotiated pension plans to which the company makes specified contributions based on hours worked. For other eligible employees, the company provides pension benefits through group annuity contracts with a life insurance company.

At the January 1, 1978 actuarial valuation date, the computed value of vested benefits for the principal plans which are funded through group annuity contracts exceeded the applicable plan assets by $7,450,000 and unfunded past service cost amounted to approximately $15,400,000.

The total charge to earnings for all plans for the year ended April 1, 1978 was approximately $35,165,000 compared with $30,085,000 for the preceding fiscal year

(8) Litigation

In addition to various claims and lawsuits arising in the normal course of business, the company and its subsidiaries are party to several matters alleging violation of certain civil rights and antitrust statutes.

The annual report for the company's fiscal year ended April 2, 1977 noted the filing of ten antitrust suits brought by alleged cattle producers and feeders against the company and numerous other retail food companies and other defendants alleging violations

of law in the purchase and sale of meat. During the company's fiscal year ended April 1, 1978, an additional eight such suits were filed against the company and other defendants All cases have been consolidated for pre-trial proceedings in the U. S. District Court in Dallas, Texas. On December 27, 1977, eleven of these cases were dismissed by the court on the basis of the decision of the U S. Supreme Court in *Illinois Brick Co. v. Illinois.* The remaining seven cases were not consolidated before the court at the time of this decision. Notices of Appeal have been filed in each of the dismissed cases. Congress is currently considering proposed legislation designed to reverse the decision of the Supreme Court in the *Illinois Brick* case which could have the effect of reinstating some or all of the cases dismissed on the basis of that decision.

Since the proceedings in these cases have not yet progressed beyond the early stages of discovery, management cannot predict the ultimate outcome. However, management believes that no basis exists for the allegations made against the company in these complaints and that it is unlikely that these law suits will materially affect the company's consolidated earnings and financial position.

(9) Segment Information

The company has classified its business activities into significant segments for fiscal year 1978 in accordance with Statement of Financial Accounting Standards No. 14. The segment information, which is an integral part of these financial statements, is included on page 11 of this report

(10) Quarterly Financial Data (Unaudited)

The following quarterly financial data is presented for the two most recent fiscal years. The quarters shown each comprised 13 weeks.

Quarter ended	Sales	Cost of merchandise sold(a)	Net earnings	Per share
	(000's omitted)			
Fiscal year 1977				
July 3, 1976	$857,148	$687,878	$ 6,971	$1 33
October 2, 1976	843,440	674,991	5,286	1.01
January 1, 1977	885,407	707,560	7,011	1 33
April 2, 1977	878,660	694,702	6,551	1.24
Fiscal year 1978				
July 2, 1977	$905,693	$716,812	$7,096	$1 35
October 1, 1977	891,554	708,206	3,032	57
December 31, 1977	965,860	764,676	6,816	1 29
April 1, 1978	974,527	761,770	9,652	1 82

(a) Including warehousing and transportation expenses.

(11) Replacement Cost Data (Unaudited)

A Securities and Exchange Commission rule requires disclosure of the estimated current replacement cost of inventories and plant assets at April 1, 1978 and April 2, 1977, together with estimated cost of merchandise sold and depreciation for the fiscal years then ended, on the basis of current replacement cost. It is anticipated that such information will provide needed insights into current costs of operations and inflation which the traditional historical cost financial statements do not disclose.

Amounts charged as depreciation and cost of merchandise sold in the accounts represent an allocation of historical cost and not cost to replace. Replacement of equipment and facilities of equivalent productive capacity, and to a limited extent inventories, requires a significantly greater expenditure of funds than the original outlay due to the cumulative effects of inflation on the price level More information on replacement cost will be included in Annual Report—Form 10-K filed with the Securities and Exchange Commission.

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS

1500 WALNUT STREET
PHILADELPHIA, PA. 19102

The Shareholders and Board of Directors
American Stores Company.

We have examined the consolidated balance sheets of American Stores Company and subsidiaries as of April 1, 1978 and April 2, 1977 and the related consolidated statements of earnings and changes in financial position for the fiscal years then ended Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of American Stores Company and subsidiaries at April 1, 1978 and April 2, 1977 and the results of their operations and changes in financial position for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis

May 15, 1978

Peat, Marwick, Mitchell & Co.

SHAREHOLDER INVESTMENT SERVICE

Dividend Reinvestment and Common Stock Purchase Plans

The First Pennsylvania Bank offers a service enabling our shareholders to invest in additional shares of the common stock of the Company This plan has several attractive options for shareholders who would like to increase their stock ownership Those interested may receive additional information by writing to First Pennsylvania Bank N A , c/o Fund/Plan Services, Inc , P O. Box 8070, Philadelphia, Pennsylvania, 19101 , or inquiries may be sent to Doris M Ulrich, Assistant Secretary, American Stores Company, One Rollins Plaza, Wilmington, Delaware, 19803 She will direct such letters to the bank.

COMMON STOCK PRICE RANGE

Calendar Quarter	High	Low
2nd 1976	31¼	26⅝
3rd 1976	33	27¾
4th 1976	32½	26¼
1st 1977	34¾	30½
2nd 1977	34¼	29¼
3rd 1977	36⅜	28½
4th 1977	31	27½
1st 1978	32	28

CASH DIVIDENDS

Calendar Quarter	Amount Paid On Common Shares
3rd 1976	.47½
4th 1976	.47½
1st 1977	47½
2nd 1977	.47½
3rd 1977	.52½
4th 1977	52½
1st 1978	52½
2nd 1978	.52½

A copy of the Company's 1978 report to the Securities and Exchange Commission, Form 10-K, is available to shareholders on request by writing: John W Edstrom, Secretary, American Stores Company, One Rollins Plaza, Wilmington, Delaware 19803.

CORPORATE HEADQUARTERS
One Rollins Plaza
Wilmington, Delaware 19803

TRANSFER AGENT AND REGISTRAR
Girard Bank
Four Girard Plaza
Philadelphia, Pennsylvania 19101

SHAREHOLDER COMMUNICATIONS
John W Edstrom, Secretary
American Stores Company
One Rollins Plaza
Wilmington, Delaware 19803
(302) 571-8733

STOCK EXCHANGES
New York Stock Exchange
Philadelphia Stock Exchange
Trading symbol: ASC

AMERICAN STORES COMPANY • DIRECTORS AND OFFICERS

Directors

William R. Deeley
President and Chief Executive Officer of the Company and American Stores Group Services, Inc

Thomas W. Field, Jr.
President and Chief Executive Officer
Alpha Beta Company

Williford Gragg
Chairman of the Board and President
United States Fidelity and Guaranty Company
(Insurance and Suretyship)

Richard E. Heckert
Senior Vice President
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(Manufacturer of Chemicals and Related Products)

James V. Jones
Executive Vice President
Armstrong Cork Company
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Virginia H. Knauer
President
Virginia Knauer & Associates, Inc
(Consumer Consultants)

Peter F McGoldrick
President and Chief Executive Officer
Acme Markets, Inc

Thomas T. Oyler
Executive Vice President of the Company and American Stores Group Services, Inc

John R. Park
Chairman of the Board

Hubert C Perry
Regional Vice President (Retired)
Bank of America (Banking)

James K. Robinson, J
Senior Vice President
American Stores Grou ices, inc

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Chairman of the Boa.d
Tosco Corporation
(Diversified Energy Company)

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Vice President

Thomas H. Sunday
Vice President

John W. Edstrom
Secretary

John G. C. Fuller
Treasurer

Doris M. Ulrich
Assistant Secretary

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President and Chief Executive Officer

Thomas T Oyler
Executive Vice President

James K Robinson, Jr.
Senior Vice President
Real Estate

J Kennedy W. Barclay
Vice President
Engineering

C. Herbert Fry
Vice President and Controller

John G. C Fuller
Vice President—Finance and Treasurer

Lester G Jones
Vice President—Personnel

Thomas H. Sunday
Vice President—Law

Rowland G Weber
Vice President—Insurance and Benefit Plans

John W. Edstrom
Vice President and Secretary

Jacqueline Paulsen
Assistant Treasurer

ACME MARKETS, INC.

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Vice Presidents	William A Dreibelbis E Paul Hasler Donald H Kohler Robert W. McCahan James A Trolier
Vice President and Secretary	Francis J Raucci, Jr
Treasurer	Robert W Simpson
Controller	Richard G Dunlop
Assistant Secretaries	John M Doerr John T Hartigan
Assistant Treasurers	Robert B Jones Jacqueline Paulsen

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Controller	Donald L. McFarland

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Executive Vice President	Thomas W King
Senior Vice President	Durward W Black
Vice Presidents	Frederic S. Cantrell Joseph E. Davis Edwin R Markson
Secretary	Ruth H. Thomas
Assistant Secretary	Robert O. Kuchenbecker

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President and Chief Executive Officer	Paul A. Morelock
Vice Presidents	Clarence J Everett John L. Hurst, Jr. Lewis M. Swinger
Secretary and Controller	William Fuller
Assistant Secretary	Joseph W Bloom

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AMERICAN STORES COMPANY

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